Non-compete restrictions in employment contracts to be limited to three months

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On 10 May 2023, the Government announced plans to reform the use of non-compete clauses in employment contracts. Legislation will be introduced which will limit such restrictions to three months. Other types of post-termination restrictions will not be affected.

What is the background to this proposal?

The reform of non-compete restrictions has been in the Conservative Government's crosshairs for some time. In May 2016 a call for evidence was launched which sought views on whether non-compete clauses stifled innovation and unfairly hindered workers from moving freely between employers. The responses to that consultation were fairly polarised with established businesses favouring the current law but new ones looking for more flexibility. The proposals were shelved by the Government at that time.

But it was back on the table again just a few years later. In December 2020, the Government launched a consultation on proposals for limiting, or potentially even banning, the use of non-compete clauses in employment contracts. The consultation was confined to non-competes and did not seek views on restricting the use of any other form of post-termination restrictive covenant such as non-solicitation clauses.

The consultation put forward two alternative proposals:

- The first proposal was that non-compete restrictions

should only be enforceable where the employer compensates the employee for the length of the restriction. This would mirror the approach taken in a number of European countries such as Germany, France and Italy. In addition, the Government sought views on supplementing this proposal with a new limit on the maximum length of such restrictions. At present, there is no maximum, but the clause must be reasonable and go no further than is necessary to protect the employer's legitimate interests. In practice, it is unusual to see non-compete restrictions exceeding 12 months and more usually they will sit around the six-month mark. The consultation sought views on whether the maximum limit should be three, six or 12 months.

- The second proposal was to ban non-compete clauses altogether, possibly with some exemptions. The consultation stressed the positive effect that such a ban could have on innovation and competition and pointed to California – where non-compete restrictions are void – as the home of the world's most innovative organisations.

What has the Government decided to do?

Despite the consultation closing over two years ago (on 26 February 2021), the Government has not yet published a response. Nonetheless, the Government has announced that it intends to legislate to limit the length of non-compete restrictions contained in employment contracts to three months. The announcement makes no reference to any requirement to compensate the employee for the length of the restriction, and so it appears that this part of the first consultation proposal has been dropped. It is said that the limitation will not extend to other types of post-termination

restriction, such as non-solicitation clauses or confidentiality restrictions (and, presumably, other types of restriction such as non-dealing clauses).

Otherwise the announcement is fairly scant, and the devil will be in the detail. For example, there are a number of important points that have yet to be made clear:

- **What is an "employment contract" for these purposes?** Will the law apply to contracts of employment only or also to other agreements which are collateral to the employment relationship e.g. shareholders' agreements, long term incentive plans (LTIP) or carried interest agreements? In Duarte v Black & Decker Corp [2007] EWHC 2720 (QB), the High Court held that restrictive covenants contained in an LTIP agreement separate from the employment contract was no bar to the LTIP agreement being treated as an "individual employment contract" for the purposes of deciding the governing law. It is possible that a similar approach will be taken in the new legislation.

- **Will "workers" be covered?** The announcement refers to "employment contracts" and "employees" only and makes no reference to individuals classified as "workers" who work under a contract to work or perform services for the employer. If it does *not* extend to workers then this would mean that longer non-competes could still be used for certain independent contractors or LLP members.

- **Will the law apply to existing employment contracts?** It is not clear whether the new law will apply

retrospectively or only to new contracts. In the event that it applies retrospectively, employers will need to renegotiate non-compete restrictions which are in excess of three months (or simply accept that they are unenforceable). Thought should also be given to strengthening other terms to offset the reduction in the non-compete restriction. For example, notice periods, non-solicit and non-dealing covenants. However, in order to ensure the enforceability of any revised terms some form of "consideration" would need to be given to the employee in return for their agreement.

- **How will the new law work alongside garden leave clauses?** The Government's announcement says that the reforms will not affect an employer's ability to use paid notice periods or place employees on garden leave. However, the risk is that employers will respond to the loss of longer non-competes by extending periods of notice in order to place the employee on garden leave and keep them out of the market that way. This would undermine the stated intention of the new law and so it seems likely that the interplay of garden leave and non-competes will need to be addressed.

What are the next steps for employers?

The Government has said the legislation will be introduced *"when Parliamentary time allows".* At the time of writing, no timeline for the introduction of the new law has been given. With a General Election looming, it remains to be seen whether the proposal will ever make its way on to the statute books.

Nevertheless, it would be sensible for employers to consider auditing existing employment contracts now to ascertain which

contain non-compete restrictions in excess of three months. Employers will also need to review relevant template contracts to make sure that any new contracts comply with the new rules if, and when, they are introduced.

BDBF is a law firm based at Bank in the City of London specialising in employment law. If you would like to discuss any issues relating to the content of this article, please contact Managing Associate Tom McLaughlin (tommclaughlin@bdbf.co.uk), Principal Knowledge Lawyer Amanda Steadman (amandasteadman@bdbf.co.uk) or your usual BDBF contact.

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